

Group's analysis demonstrates that many other Signatories (many of whom are vertically integrated and, unsurprisingly, are thus their own best customers for space segment) would view such a practice as basically harmless; carriers would like this outcome; and INTELSAT itself would have reason to respond to the U.S. carriers' demands.¹²⁵ However, this result would not represent the elimination of any "excess profits"; it would simply mean that carriers obtained space segment at artificially low prices—at the expense of both COMSAT and, ultimately, the U.S. taxpayer.¹²⁶

B. The Record Does Not Rebut COMSAT's Showing That an IUC-Only Return Under a Level 3 Access Regime Would Not Be Compensatory

Many parties contend that the return COMSAT obtains through the IUC mechanism would be adequate to compensate the company for its loss of retail business under Level 3 direct access. In so doing, they generally repeat the Commission's tentative conclusion on this issue.¹²⁷ The analysis in the *Notice* reflects a fundamental misunderstanding of the true return obtained by COMSAT through the IUC mechanism.

First, as a preliminary matter, it is important to clarify that COMSAT is not "guaranteed" any return from INTELSAT, much less one of 21%. The IUC return fluctuates

¹²⁵ *Id.* at IV.B.2 & Appendix 3 at 13-14.

¹²⁶ *Id.* at IV.B.1 & Appendix 3 at 7-9. As George Bernard Shaw observed, "[a] government which robs Peter to pay Paul can always depend on the support of Paul." George Bernard Shaw, *Everybody's Political What's What?*, chapter 30 (1944).

¹²⁷ *See, e.g.*, Network Comments at 17; GE Americom Comments at 11; Cable & Wireless Comments at 4; Sprint Comments at 9; PanAmSat Comments at 6.

each year based on the level of INTELSAT's revenues, and COMSAT faces the same risk as any other business that there may be *no* return in a bad year.

Second, as COMSAT's initial comments point out, the IUC-provided return is *pre-tax*.¹²⁸ Accordingly, the 18% "return" provided through the IUC mechanism in 1997 translated into a 11.0% after-tax return on the book value of COMSAT's Signatory equity, significantly lower than the corresponding returns on book equity realized by established U.S. telecommunications services companies.¹²⁹

Third, even the 11.0% after-tax figure is *on equity alone*. COMSAT also is liable for its share of INTELSAT debt, which lowers its actual return even more. Indeed, the use of an IUC mechanism would have afforded COMSAT only a 10.1% return under a "return on total capital" measure in 1997—and under a "return on net plant" analysis (the measure most closely related to the regulatory concept of return on rate base), COMSAT's IUC-based return in 1997 would have been only 9.2%.

Fourth, because INTELSAT makes IUC-related adjustments only once a year, a significant lag would occur between the provision of space segment by INTELSAT to U.S. direct access customers and the receipt by COMSAT of the corresponding IUC-related payment.¹³⁰ Under direct access, COMSAT would no longer receive direct payments from

¹²⁸ See COMSAT Comments IV.B.2 at Appendix 3 at 28.

¹²⁹ COMSAT Comments, Appendix 3 at 28 (noting that the after-tax return on book equity for Value Line's composite of established U.S. telecommunications companies has been approximately 27% since 1996 and predicting a rate of return of 28% for the years through 2003).

¹³⁰ *Id.*

customers on a monthly basis, but would receive only IUC-related payments from INTELSAT a number of months later. These significant delays in COMSAT's revenues would impose additional costs on the company (such as increased working capital requirements) and thus further reduce the true value of the already inadequate IUC-related return.

Fifth, the simple comparison of IUC-related returns to those of most telecommunications companies also ignores the investment obligations and limited liquidity faced by INTELSAT Signatories relative to the opportunities facing investors in other telecommunications entities. As COMSAT's initial comments pointed out, Signatories (unlike shareholders in a private company) are subject to capital calls on the order of hundreds of millions of dollars annually, assessed in proportion to ownership share, and payable regardless of whether the individual Signatory benefits from the investment.¹³¹ In addition, Signatories are "locked in" to their INTELSAT investments. They may alter their investment shares only through an internal INTELSAT process, and they may not sell their investments on public markets. These and other limitations on the liquidity of Signatory investments increase the costs of those investments.

Finally, INTELSAT Signatories, unlike shareholders of corporations, are jointly and individually liable for the entire INTELSAT system. This increases the risk, and the corresponding necessary market return, compared to investments in otherwise similar U.S. international telecommunications firms.

This summary should help the Commission understand the error in assuming that the "return" available through the IUC mechanism alone would adequately compensate COMSAT

for its costs in a Level 3 environment. In short, INTELSAT's IUCs are not set to achieve that result, and it is therefore no surprise that they fail to do so.

C. Claims That a Surcharge Is Not Required Based on Practices in Other Countries Are Irrelevant

Confusion about the IUCs and the return that they provide also form the basis of the claims by commenters that a Signatory surcharge would be unnecessary under a Level 3 direct access regime in the United States.¹³² The "experience" of other Signatories who have implemented Level 3 access without a surcharge—and urge the FCC to do the same—actually supports COMSAT's position that a surcharge would be a legal necessity in this country.¹³³

For example, BT does not claim that it incurs no costs in performing its Signatory functions in the United Kingdom.¹³⁴ Rather, BT states that the "administrative burden" of identifying these costs and trying to separate them from its other commercial activities is not worth the effort.¹³⁵ That underscores the point that COMSAT makes in this proceeding: To a vertically and horizontally integrated, multi-billion dollar dominant national carrier like BT—whose INTELSAT business revenue is reported in the "other" category in its annual reports and whose ownership share in INTELSAT is a third of that of COMSAT—lumping its

(Continued)

¹³¹ *Id.* at 32.

¹³² *See, e.g.*, GE Americom Comments at 9; MCI WorldCom Comments at 16; Sprint Comments at 9-10.

¹³³ *See* BT North America Comments at 3-4; Cable & Wireless Comments at 5.

¹³⁴ BT North America Comments at 5.

¹³⁵ *Id.*

Signatory costs together with its other commercial undertakings to be borne by consumers is a routine practice that apparently does not warrant regulatory scrutiny in Britain, *even though BT implicitly concedes that non-INTELSAT users are bearing those costs.*

In contrast, COMSAT's primary business (and the reason for which it was created by Congress) is to invest in, and offer equitable access to, the satellite capacity COMSAT owns on the INTELSAT system. No other Signatory is similarly confined or given such responsibilities.

COMSAT's statutory obligation to ensure adequate space segment of the type and variety to meet the requirements of competing U.S. carriers and broadcasters, and to use its predominant ownership stake to influence INTELSAT policies subject to the U.S. instructional process, creates significant unavoidable costs that are spelled out in COMSAT's opening comments. Unlike BT, COMSAT cannot allow these costs and expenses to be shifted to other "commercial undertakings," as BT apparently does; the FCC would never tolerate such cross-subsidization. In short, BT's experience in the United Kingdom is entirely irrelevant to an objective analysis of Level 3 direct access in this country—or its economic impact on COMSAT.

The difference between the abundance of facilities-based international service competitors in the United States and the lack of such alternatives in foreign markets also accounts for why Teleglobe's offering of INTELSAT-based services at allegedly lower rates does not demonstrate that COMSAT's rates are supranormal.¹³⁶ First, the Commission must

¹³⁶ See, e.g., Sprint Comments at 8. Globecast makes the claim that some U.S. customers choose to use Teleglobe because they do not like to do business with COMSAT. Globecast (Continued...)

remember that Teleglobe is a vertically integrated carrier with a dominant position in its home (Canadian) market. Teleglobe's vertical integration allows it to set a lower price for one segment of its services (here, INTELSAT capacity) in order to boost demand for complementary (vertically-integrated) segments of its offerings on which it can realize a greater profit margin. This does not necessarily require that Teleglobe set prices for INTELSAT capacity below cost; however, Teleglobe's vertical integration does allow it to accept lower margins than COMSAT for INTELSAT capacity in order to enable it to garner additional profits from the opinion of other services, including earth station services as well as end-to-end international services.¹³⁷ Thus, Teleglobe (and certain other foreign Signatories) rationally can accept lower margins for U.S. INTELSAT traffic in order to stimulate beneficial complementary effects for other portions of its network.¹³⁸ COMSAT, in contrast, has no "other network" to offset such lower margins.

Second, Teleglobe's routing of INTELSAT traffic between the U.S. and third countries is a form of "transit" traffic (from Canada's perspective) and is not subject to regulation by

(Continued)

Comments at 4. But that is the whole point: whatever their reasons, customers do have choices for INTELSAT capacity today.

¹³⁷ Although Canada has begun opening its markets and recently implemented direct access, Canadian regulators have so far refused to deregulate Teleglobe because it retains power to, among other things, engage in cross-subsidization. The Canadian Radio and Television Commission ("CRTC") in October 1998 denied Teleglobe's request for deregulation because the company had "not substantiated [its] submission sufficiently to permit the Commission to find that Teleglobe's services are, or are likely to be, subject to a degree of competition sufficient to protect the interests of users." CRTC Decision 98-17, Oct. 1, 1998, at ¶ 214.

¹³⁸ To analogize, an airline that offers a connection from point 1 to 2 and from 2 to 3 (with point 2 being a hub) has an incentive to price the connection between points 1 and 2 lower

(Continued...)

Canadian authorities. Canada has sought to promote transit traffic in order to obtain “marginal” revenue for the presumptive benefit of Canadian customers, and it is unsurprising that Teleglobe can offer lower rates than COMSAT. Since COMSAT, by contrast, cannot discriminate among U.S. customers for U.S. originating or terminating traffic, Teleglobe can undercut COMSAT’s prices without regulatory oversight.¹³⁹

D. Nothing in the Record Suggests that End Users Will Actually See Any Price Reductions as a Result of Allowing Level 3 Direct Access

Several commenters have suggested that direct access to INTELSAT will yield significant cost savings to U.S. consumers of international telecommunications services.¹⁴⁰ These commenters, however, have exaggerated beyond recognition the magnitude of any such potential “savings.”¹⁴¹

(Continued)

than an airline that serves only that route.

¹³⁹ Sprint discounts the impact of Teleglobe on the choices available to U.S. customers by citing how “costly” it is to route its traffic to Canada. *See* Sprint Comments at 8. With the tremendous abundance of fiber between the United States and Canada, even a casual examination of the market will show that this “cost” is virtually *de minimis*. In fact, the inexpensive nature of fiber links between the United States and Canada is one of Teleglobe’s primary selling points. *See, e.g., Teleglobe Continues Expansion in United States* (McLean, Va., Jan. 14, 1999) (Teleglobe press release) (available at (visited Jan. 29, 1999) <<http://www.teleglobe.com>. >); (“through our recent merger with [U.S.-based] Excel Communications, our customers will see even greater coverage and savings now that Teleglobe’s overseas network has been integrated with Excel’s U.S. nationwide fiber optic network”).

¹⁴⁰ *See, e.g.,* AT&T Comments at 11; BT North America Comments at 7; Cable & Wireless Comments at 3; GE Americom Comments at 8-9.

¹⁴¹ A number of commenters rely on the SUC Study in an attempt to quantify the alleged savings. *See* AT&T Comments at 11-12; Cable & Wireless Comments at 2; GE Americom Comments at 8; Loral Comments at 5; MCI WorldCom Comments at 12; PanAmSat

(Continued...)

As COMSAT explained in its initial comments—and as the Commission has known for over a decade—the cost of COMSAT-provided space segment accounts for only an insignificant fraction of what U.S. end users pay for international carrier services.¹⁴² For this reason, even the *de minimis* cost reductions that might accrue to U.S. carriers under a direct access regime would not measurably benefit end users.

Further, for reasons explained in both the Brattle Analysis and COMSAT's initial comments, any savings achieved by U.S. retail carriers under direct access and not appropriated by foreign carriers through price increases on the foreign half-circuit would most

(Continued)

Comments at 6; Sprint Comments at 6. Professors Houthakker and Schwartz, together with The Brattle Group, already have demonstrated that the SUC Study's methodology is riddled with errors. See COMSAT Comments Appendix 3, Attachment 1, Analysis of SUC Study at 11-15. For one thing, the SUC Study relies on miscalculated operating margins; its comparison of ISO operating margins relative to PanAmSat's operating margin is a "serious conceptual problem" because "operating margins are neither a measure of productivity nor a measure of 'price-cost margins.'" *Id.* at 11 (noting that capital-intensive industries generally have high operating margins to cover debt service expenses and provide a return on investment; operating margins "also are greatly dependent on accounting treatment"). The SUC Study also relied on misleading figures for PanAmSat, understating its recent operating margin by almost 20%; the corrected figure "is essentially identical" to INTELSAT's operating margin. *Id.* And the SUC Study's estimated service expansion—*i.e.*, its calculation of the value of additional output of various services that would be created by price reductions for ISO services—is "overstated by at least a factor of twenty." *Id.* at 12 (showing that SUC Study fails to reflect the "small fraction" of retail charges due to the cost of satellite services). When these errors and other miscalculations are corrected, the SUC Study methodology indicates that "direct access benefits would be *zero*." *Id.* at 14 (emphasis in the original).

¹⁴² See COMSAT Comments at IV.B.4. In 1984, the Commission concluded that even if passed through to end users, "savings" from direct access would represent only a few percentage points of the total end-user charge. *1984 Order* at 325. The Brattle Group estimates that today such savings would amount to only 1.3% of total end user charges, even if INTELSAT services were provided *free*. See COMSAT Comments at IV.B.4, n.200.

likely be retained by the U.S. retail carriers.¹⁴³ There is simply no reason to believe that such savings would ever be passed through to consumers.

The Commission's *Notice* specifically directed "[c]arriers seeking direct access [to] comment on how they would pass any cost savings to consumers in view of the efficiencies that they predict would result from direct access."¹⁴⁴ In response, several carriers blithely assured the Commission that direct access would create savings for carriers and users alike,¹⁴⁵ and some even claimed that market forces would require them to pass through such savings.¹⁴⁶ This argument gives new meaning to the word "chutzpah."¹⁴⁷ If market forces are enough to ensure the lowest possible rates for AT&T, MCI WorldCom, and Sprint, the same market forces require COMSAT to offer the lowest possible space segment rates that it can. The carriers cannot have it both ways.

In any event, none of the carriers responded to the Commission's request to quantify their expected savings related to particular services they now obtain from COMSAT or

¹⁴³ See COMSAT Comments at IV.B.4 & Appendix 3 at 57-59.

¹⁴⁴ *Notice* at ¶ 51 (emphasis added).

¹⁴⁵ See AT&T Comments at 11; BT North America Comments at 7; Cable & Wireless Comments at 3; GE Americom Comments at 8-9; Globecast Comments at 3-4; ICG Comments at 3; IT&E Comments at 2-3; MCI WorldCom Comments at 14; Sprint Comments at 7.

¹⁴⁶ See, e.g., MCI WorldCom Comments at 14-15.

¹⁴⁷ See *Southwestern Bell Corp. v. FCC*, 896 F.2d 1378, 1381 n.2 (D.C. Cir. 1990) (taking a self-serving litigating position that is functionally inconsistent—even if not “strictly inconsistent”—with an earlier self-serving position “borders on ‘chutzpah.’”) (citing *Northwest Airlines, Inc. v. Air Line Pilots Ass’n Int’l*, 808 F.2d 76, 83 (D.C. Cir. 1987)).

explained *how* they would pass their cost savings through to consumers.¹⁴⁸ Nor did they specify the timing for delivering any savings to consumers.¹⁴⁹ Certainly, no carrier announced any specific and verifiable commitment to lower its international service rates upon implementation of direct access. This silence speaks volumes.

As further evidence that end-user customers are unlikely to realize reduced prices if direct access is implemented, COMSAT demonstrated in its comments that basic rates on international routes have been increasing at the same time that long-distance companies' space segment costs of providing service have been dropping.¹⁵⁰ Although MCI WorldCom claims in its comments that international calling prices have declined up to 51% (with an average of 13%) during the last year,¹⁵¹ this response does not refute COMSAT's showing. In making this argument, MCI WorldCom relies on a survey of the best-available rates that the three major carriers offer on the five largest U.S. international routes (Canada, Mexico, Germany, India, and Japan), which fails to address the rates that the carriers offer to nearly 240 other nations.¹⁵² The limited nature of this data regarding the best possible calling plans in five

¹⁴⁸ See Notice at ¶ 51.

¹⁴⁹ *Id.*

¹⁵⁰ COMSAT Comments at IV.B.4.

¹⁵¹ MCI WorldCom Comments at 15.

¹⁵² *Id.* (citing Report on International Telecommunications Markets 1997-1998 (Prepared for Senator Ernest F. Hollings), at Introduction, 1 (Dec. 7, 1998)). Further, the study submitted with COMSAT's initial comments does not include Canada and Mexico because COMSAT does not provide service in either of these countries. See COMSAT Comments, Appendix 3, Attachment 2 (Professor Marius Schwartz of Georgetown University, *Introducing Direct Access by U.S. Users to INTELSAT: An Economic Assessment* (Sept. 1997)).

highly competitive markets hardly provides an accurate depiction of the trends with respect to overall international rates, and it certainly does not refute COMSAT's showing that the average *basic* rates available on *all* international routes have been going up

VIII. COMMENTERS' CALLS FOR THE IMPOSITION OF "FRESH LOOK" AND "PORTABILITY" ARE PROCEDURALLY FLAWED AND, IN ANY CASE, DIRECTLY CONTRARY TO RECENT COMMISSION AND COURT RULINGS THAT COMSAT'S LONG-TERM CONTRACTS DO NOT IMPEDE COMPETITION

Some parties have used their direct access comments to call for the imposition of additional extreme measures which have no place in this proceeding. Several argue that direct access should be accompanied by a "fresh look" period, during which carriers would be free to abrogate their existing commitments to purchase INTELSAT capacity from COMSAT.¹⁵³ A couple of commenters go even further, contending that INTELSAT space segment capacity that is already subject to commitments between COMSAT and INTELSAT should be "portable" under a direct access regime.¹⁵⁴ They thus would have the benefit of a government-compelled transfer of COMSAT's existing contract rights with INTELSAT.

These requests are procedurally defective and substantively meritless. As a procedural matter, because neither fresh look nor portability was raised in the *Notice*, the Administrative Procedures Act ("APA") bars the FCC from considering them now. And with respect to the substance, these unsolicited requests are indefensible on the law and the facts. Under well-established Commission precedent, fresh look can be imposed only when, in a transition from

¹⁵³ See AT&T Comments at 13-15; ICG Comments at 5-6; Loral Comments at 8-9; MCI WorldCom Comments at 25-28; PanAmSat Comments at 9-10; Sprint Comments at 10-13.

a monopoly to a competitive market, existing contracts have “locked up” the business and thus stymied the working of natural market forces. But here, as the FCC determined less than a year ago, the opposite is true—more than 80% of U.S. overseas traffic in the switched voice market falls outside COMSAT’s existing inter-carrier contracts *and* these agreements “do not impede COMSAT’s customers from switching service providers.”¹⁵⁵ Moreover, given that there is no factual case for fresh look, by definition there is no case for portability either.

A. The Requests for Imposing Fresh Look and Portability Are Procedurally Flawed

The issues of fresh look and portability have not been raised in this proceeding, and the Commission therefore may not adopt them. Neither measure was even suggested in the *Notice* as a possible outcome of the implementation of direct access. Under both the APA and the Commission’s own regulations, the FCC may not establish rules on matters not raised in a published notice of proposed rulemaking.¹⁵⁶

Thus, for example, the Commission two years ago declined to invoke its fresh look doctrine in the *International Section 214* proceeding because the proposal “goes far beyond the scope of this proceeding” and would “deny many interested parties the opportunity to

(Continued)

¹⁵⁴ See MCI WorldCom Comments at 29-30; Sprint Comments at 13.

¹⁵⁵ *Non-Dominance Order*, 13 FCC Rcd at 14121.

¹⁵⁶ See 5 U.S.C. § 553(b); 47 C.F.R. § 1.413(c); see also, e.g., *Nader v. FCC*, 520 F.2d 182, 204 (D.C. Cir. 1975); *MCI Telecommunications Corp. v. FCC*, 57 F.3d 1136, 1140 (D.C. Cir. 1995).

comment because the issues were not raised in the *Notice*.¹⁵⁷ Courts also have held that omitting the issue of fresh look from a published notice precludes adoption of the measure.¹⁵⁸

COMSAT's limited response here to the unsolicited calls by some commenters for fresh look does not cure the procedural defect. The Commission and the courts have recognized fresh look as a discrete issue requiring specific reference in an agency notice because it raises significant "constitutional, statutory or common law implications."¹⁵⁹ The notion of "portability" raises equally discrete—and serious—questions of constitutional and statutory law. Thus, if the agency were to grant commenters' unsolicited requests for fresh look or portability, the failure of the *Notice* to alert COMSAT that the Commission deemed these measures to be important adjuncts to direct access would be clear grounds for court reversal.

B. Even If Proper Notification for Fresh Look Had Been Provided, It Is Not Appropriate in this Proceeding

Setting aside these procedural infirmities, the circumstances here do not meet the rigorous factual predicate required before the Commission may contemplate such extraordinary government intervention into private contractual relationships. Indeed, the standard for

¹⁵⁷ See *Streamlining the International Section 214 Authorization Process and Tariff Requirements*, 11 FCC Rcd 12884, 12920-21 (1996); see also *Telecommunication Services Inside Wiring*, 13 FCC Rcd 3659, 3780 (1997) (FCC recognizing need to seek comment on FCC's "statutory authority" to impose fresh look treatment on cable operators, as well as comment on "any other constitutional, statutory or common law implications" raised by the proposal).

¹⁵⁸ *Bell Atlantic Telephone Companies v. FCC*, 24 F.3d 1441, 1447 (D.C. Cir. 1994) (remanding "fresh look" requirement adopted after insufficient notice under the APA).

imposing fresh look treatment is so rigorous and the measure so extraordinary that the FCC has employed it only four times in the last 65 years.¹⁶⁰ A fresh look period may be adopted only when the agency makes three factual findings: (1) the entity at issue has market power; (2) the entity has exercised that power to create long-term contracts that “lock up” so much of the relevant market that the agreements constitute “unreasonable barriers” to competition; and (3) the contractual obligations may be nullified without harm to the public interest.¹⁶¹ None of the requisite elements is present here.

1. COMSAT does not have market power in the U.S. international marketplace, and did not at the time the existing contracts were formed

Several commenters contend that because COMSAT currently has an exclusive right to provide INTELSAT space segment in the United States, it has market power that would justify

(Continued)

¹⁵⁹ *Telecommunication Services-Inside Wiring*, 13 FCC Rcd at 3780.

¹⁶⁰ *See Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, 11 FCC Rcd 15499, 16044-45 (1996) (First Report and Order) (nullifying termination liability provisions in “nonreciprocal” transport and termination contracts between *de facto* monopolist LECs and wireless network service providers); *Expanded Interconnection with Local Telephone Company Facilities*, 8 FCC Rcd 7341, 7342, 7346-48 (1993) (Second Memorandum Opinion and Order on Recon.) (“*Expanded Interconnection Order*”) (nullifying some but not all termination liability provisions in contracts of *de facto* monopolist LECs governing special access interconnection terms); *Competition in the Interstate Interexchange Marketplace*, 7 FCC Rcd 2677, 2682-83 (1992) (Memorandum Opinion and Order on Recon.) (“*Interexchange Competition Order*”) (ordering *de facto* monopolist carriers to offer 800 number services on unbundled basis); *Allocation of the 849-851 MHz/894-896 MHz Bands*, 6 FCC Rcd 4582, 4583 (1991) (Memorandum Opinion and Order on Recon.) (“*Air-Ground Telephone Service Order*”) (nullifying termination liability provisions in air-ground telephone service contracts between “*de facto* monopol[ist]” GTE Airfone and airlines).

¹⁶¹ *See Expanded Interconnection Order*, 8 FCC Rcd at 7342, 7346-48; *Air-Ground*
(Continued...)

a fresh look period to reopen COMSAT's long-term inter-carrier agreements.¹⁶² However, the Commission already has determined that, even with its exclusive service franchise, COMSAT does not have market power.¹⁶³ Thus, the appropriate inquiry is not whether COMSAT has exclusive access to INTELSAT, but whether the carriers have had alternatives to COMSAT.

The Commission has twice answered "yes" to that question, and has determined on that basis that the contracts in question do not impede competition. In the 1996 *Streamlined Tariffing Order*, the FCC noted the explosive growth of fiber-optic cable capacity, as well as satellite capacity, and found that COMSAT's customers are price-sensitive and have the ability to use a supplier other than COMSAT for many, if not most, space segment services.¹⁶⁴ And in the 1998 *Non-Dominance Order*, the FCC specifically found that COMSAT lacked the market power to compel the carriers to enter into the existing long-term contracts (which were signed in 1993 and 1994).¹⁶⁵

(Continued)

Telephone Service Order, 6 FCC Rcd at 4583.

¹⁶² ICG Comments at 6; Loral Space Comments at 9; MCI WorldCom Comments at 25; Sprint Comments at 12.

¹⁶³ *Non-Dominance Order*, 13 FCC Rcd at 14121. By pointing to COMSAT's exclusive franchise to provide INTELSAT-based services in the United States, the commenters suggest or imply that INTELSAT space segment service is somehow a market distinct from other satellite- or fiber-optic cable-based transmission service. This is, of course, absurd. *See, e.g., Non-Dominance Order*, 13 FCC Rcd at 14103, 14114 (determining that fiber-optic cables are substitutable in the switched voice and private line market and that separate satellite systems are substitutable in the video market).

¹⁶⁴ *In re COMSAT Corporation Petition for Partial Relief From the Current Regulatory Treatment of COMSAT World System's Switched Voice, Private Line, and Video and Audio Services*, 11 FCC Rcd 9622, 9630-31 (1996) ("*Streamlined Tariffing Order*").

¹⁶⁵ *Id.* at 14121.

Courts also have made similar findings that COMSAT lacked power to compel the carriers to enter into long-term agreements. Indeed, in rejecting PanAmSat's antitrust suit against COMSAT, the trial court explicitly found that:

nothing in the record suggests that COMSAT secured any of [its long-term] contracts by means of any anticompetitive act against PAS. To the contrary, the record suggests that for their own reasons, the common carriers elected to secure long-term deals with COMSAT *only after considering and rejecting offers from PAS*.¹⁶⁶

In the face of these substantive findings, the suggestion that the carriers were "forced" to enter into these commitments is meritless.¹⁶⁷ The FCC has no basis here upon which to justify the drastic imposition of a fresh look period.

2. The FCC already has found that these very contracts do not "lock up" the market so as to impede competition

The Commission's *Non-Dominance Order* also specifically concludes that COMSAT has not "locked up" the market for international switched voice service through its long-term contracts with carriers for INTELSAT capacity. The *Order* notes that these contracts represented less than 25% of the switched voice market in 1997 and that—given the substantial

¹⁶⁶ *Alpha Lyracom Space Communications, Inc. v. COMSAT Corp.*, 968 F. Supp. 876, 1997-1 Trade Cases ¶ 71679, 79821 (S.D.N.Y. 1996), *aff'd*, 113 F.3d 372 (2d Cir. 1997). Because the court reviewed the matter and squarely decided that the carriers had—and made—competitive choices in entering these contracts, the Commission is estopped from concluding to the contrary. See, e.g., *Allen v. McCurry*, 449 U.S. 90, 94 (1980); *United States v. Utah Constr. & Mining Co.*, 384 U.S. 394, 422 (1966) (*res judicata* principles apply in administrative adjudication).

¹⁶⁷ Contracts that offer lower rates in exchange for long-term commitments do not compel anyone to take service—as the Commission has explicitly held. See *Non-Dominance Order*, 13 FCC Rcd at 14121. To the extent that some parties make this claim, see, e.g., Sprint Comments at 10-11, it is preposterous on its face.

growth rate in this market—the contracts likely would represent an even smaller market share in the future.¹⁶⁸ Stated another way, the vast majority of international voice traffic is outside these contracts; U.S. carriers have ample alternatives, including their own fiber-optic cables, to send this traffic overseas. This is not, by any means, a case for application of the fresh look doctrine. The FCC concluded just nine months ago that “COMSAT’s long-term contracts do not impede COMSAT’s customers from switching service providers,”¹⁶⁹ and this ruling is consistent with the Commission’s previous findings in the 1996 *Streamlined Tariffing Order*.¹⁷⁰ Thus, the agency’s own recent rulings demonstrate that imposition of a fresh look period here would not comport with the second predicate for fresh look because no customer is “locked up” by these contracts.

3. Imposition of a fresh look period would not serve the public interest

Finally, the Commission will not impose the drastic measure of fresh look treatment if the agreements at issue serve the public interest.¹⁷¹ COMSAT’s inter-carrier contracts have served the public interest substantially. On the basis of these long-term commitments, COMSAT and INTELSAT have planned and “sized” the INTELSAT system and have procured satellites specifically to meet customer needs. Moreover, on the basis of these

¹⁶⁸ *Non-Dominance Order*, 13 FCC Rcd at 14120-21.

¹⁶⁹ *Id.* at 14121.

¹⁷⁰ *Streamlined Tariffing Order*, 11 FCC Rcd at 9631.

¹⁷¹ *See Expanded Interconnection Order*, 8 FCC Rcd at 7346; *Air-Ground Telephone Service Order*, 6 FCC Rcd at 4583.

commitments, COMSAT has been able to enter into firm capacity arrangements with INTELSAT that have lowered prices for *all* customers, not just the major carriers.

COMSAT is bound to these arrangements with INTELSAT for a period of up to 15 years. Agency action nullifying the customer contracts that facilitated these arrangements would give the carriers the benefit of their bargain—lower rates since 1993-94—while relieving them of the reciprocal obligations into which they freely entered in exchange for these lower rates. COMSAT, in contrast, would remain fully liable to INTELSAT but would have no longer have a contract revenue backlog with which to meet its obligations. Thus, COMSAT would suffer all the financial harm, while the carriers and INTELSAT itself would escape the impact.¹⁷²

In short, FCC precedent affords no basis for imposing a fresh look period in conjunction with direct access. The agency's own findings negate each of the three factual predicates necessary to justify the extreme measure: (1) COMSAT lacks market power in the switched voice service market, (2) COMSAT has not "locked up" this market through its long-term carrier contracts, and (3) the long-term agreements serve the public interest.

C. Even if Proper Notification for Portability Had Been Provided, It Is Not Appropriate Here

Two carriers call for another extreme measure that hinges upon the imposition of fresh look treatment: a Commission order requiring so-called "portability" of INTELSAT space

¹⁷² Such harm would, of course, subject the U.S. government to liability for compensation to COMSAT. *See supra* Section IV.

segment capacity in conjunction with direct access.¹⁷³ This mandate would force COMSAT to relinquish INTELSAT capacity that it already owns when a COMSAT customer opts to pursue direct access.

As support for this drastic step, MCI makes the outlandish contention that portability of INTELSAT capacity is somehow analogous to telephone number portability—an issue explicitly mandated by the Telecommunications Act of 1996.¹⁷⁴ The two settings have absolutely nothing in common. In action predating the 1996 Act, the Commission recognized that toll-free telephone numbers have an obvious intrinsic value to end-users.¹⁷⁵ Customers' 800 numbers should be portable, the FCC decided, because of the unique value which is attached to them. This special value, in turn, threatened to block the natural functioning of a competitive marketplace: Customers likely would be reluctant to switch carriers because that would mean "forfeiting the value of their old 800 numbers, including any value inherent in the number itself, as well as any other goodwill associated with the number."¹⁷⁶ Similarly, in implementing the statutory number portability provision, the agency noted that:

the absence of number portability likely would deter entry by competitive providers of local service because of the value customers place on retaining telephone numbers. Business customers, in particular, may be reluctant to incur

¹⁷³ MCI WorldCom Comments at 29-30; Sprint Comments at 13.

¹⁷⁴ MCI WorldCom Comments at 29. 47 U.S.C. § 251(b)(2).

¹⁷⁵ *Competition in the Interstate Interexchange Marketplace*, 6 FCC Rcd 5880, 5904 (1991) (subsequent history omitted).

¹⁷⁶ *Id.* at 5904.

the administrative, marketing, and goodwill costs associated with changing telephone numbers.¹⁷⁷

In contrast to the matchless value of 800 numbers, there is nothing unique about international transmission capacity. Telephone numbers may have intrinsic worth to end-users that would provide them with a disincentive against switching carriers, but capacity on INTELSAT satellites is entirely fungible with capacity on rival satellite systems or cable systems. Thus, the Commission's purpose in implementing portability with respect to 800 numbers is not analogous to—and cannot justify—portability here. Moreover, as noted above, the portability concept is necessarily linked to fresh look treatment. Because no basis for a fresh look period exists, it follows that there can be no basis for portability either. In any event, neither the FCC nor any other regulatory authority has the ability to abrogate the service arrangements between INTELSAT and its Signatories.¹⁷⁸ Accordingly, the FCC has no jurisdiction to order “portability” in these circumstances.

¹⁷⁷ *Telephone Number Portability*, 13 FCC Rcd 11701, 11703-04 (1998).

¹⁷⁸ Administrative Response to Chairman Bliley.

IX. CONCLUSION

For the reasons presented here and detailed in its opening comments, COMSAT Corporation respectfully submits that implementation of Level 3 direct access to INTELSAT in the United States would not be in the public interest. Just as the Commission has concluded each and every time it has examined the issue, the "adverse consequences" of direct access far outweigh the claimed benefits.

Respectfully submitted,

COMSAT Corporation

By: 
Warren Y. Zeger

Howard D. Polsky

Keith H. Fagan

Bruce A. Henoch

Richard E. Wiley
Lawrence W. Secrest, III
William B. Baker
Rosemary C. Harold

WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006
(202) 719-7000

COMSAT CORPORATION
6560 Rock Spring Drive
Bethesda, Maryland 20817
(301) 214-3000

January 29, 1999

ATTACHMENT

J. GREGORY SIDAK
1150 SEVENTEENTH STREET, N.W.
ELEVENTH FLOOR
WASHINGTON, D.C. 20036
202-862-5892

January 29, 1999

Warren Y. Zeger, Esq.
Vice President and General Counsel
Comsat Corporation
6560 Rock Spring Drive
Bethesda, Maryland 20817

Re Opinion of Law Concerning Initial Comments of Various Parties in *Direct Access to the INTELSAT System*, IB Docket No. 98-192

Dear Mr. Zeger:

This letter responds to your request that I provide Comsat Corporation my opinion of law on questions raised by several major telecommunications carriers in their initial comments in *Direct Access to the INTELSAT System*, IB Docket No. 98-192.

My qualifications are detailed in my December 22, 1998, opinion letter to you.¹ I present this legal opinion in my individual capacity as a member of the Bar of the District of Columbia and not on behalf of the American Enterprise Institute or the Yale School of Management.

This opinion of law is organized in four parts. Part I explains that the companies filing initial comments endorsing Level 3 direct access to space segment capacity on the INTELSAT system have presented a superficial and incorrect analysis of the takings and regulatory contract issues on which the Commission requested comment. Part II examines mandatory Level 4 direct access and concludes that such regulatory intervention would even more clearly effect an unconstitutional taking of property than would Level 3 direct access. Part III examines the proposals for "fresh look" and "portability" and concludes that such regulatory intervention would be a forced transfer of Comsat's existing contract rights to its customers that would effect an uncompensated taking of property.² Part IV provides additional analysis of how Level 3 direct access would effect a physical occupation of Comsat's property.

1. Opinion of Law Concerning the Constitutionality of the Commission's Proposal in *Direct Access to the INTELSAT System*, IB Docket No. 98-192, to Require Level 3 Direct Access to Space Segment Capacity on the INTELSAT System, Letter from J. Gregory Sidak to Warren Y. Zeger, December 22, 1998.

2. The Commission's imposition of fresh look, portability, and Level 4 direct access also would breach Comsat's regulatory contract with the United States. For brevity, and because the analysis under the contract theory would not differ dramatically from the analysis under takings jurisprudence, this opinion of law is confined to whether such policies would violate the Takings Clause.

Warren Y. Zeger, Esq.
January 29, 1999
Page 2

I. THE PROPONENTS OF LEVEL 3 DIRECT ACCESS INCORRECTLY
ANALYZE THE TAKINGS AND REGULATORY CONTRACT ISSUES

Despite the importance that the Commission's NPRM placed on the takings and regulatory contract issues associated with Level 3 direct access, the major companies filing comments in support of such access fail to provide any rigorous legal, economic, or factual analysis of those issues. A number of commenters baldly assert, without any rationale or authority, that Level 3 direct access does not raise takings or regulatory contract issues; others merely regurgitate and endorse the Commission's tentative conclusions on these issues.³ AT&T's discussion of the takings and regulatory contract issues is longer,⁴ but it too fails to rise above superficiality. Surely, for example, AT&T's discussion does not reflect the level of sophistication that AT&T could be expected to bring to bear on such legal questions if, say, the Commission were to propose direct access for competing Internet service providers seeking to reach consumers through TCI's cable television infrastructure.⁵

AT&T makes two arguments. First, AT&T argues that Comsat lacks any property right in exclusive access to the INTELSAT system from the United States. Second, AT&T argues that, even if Comsat has such a property right, the Commission's imposition of Level 3 direct access would not be an unconstitutional taking of that right. Both arguments (as framed by the Commission in its NPRM) were analyzed at length in my December 22, 1998, opinion letter and rejected. After their restatement by AT&T, both arguments are still incorrect.

In arguing that Comsat lacks a property right, AT&T simply parrots to the Commission what it already said in paragraphs 33 through 36 of the NPRM.⁶ Because it adds no independent legal analysis to this question, AT&T repeats the Commission's own mistakes in mischaracterizing the legal significance of *United States v. Winstar Corporation*⁷ and erroneously assuming that *The Binghamton Bridge*⁸ is the only other Supreme Court decision relevant to the regulatory contract or related takings questions. Like the Commission's NPRM, AT&T ignores a long line of Supreme Court decisions enforcing a regulatory contract against the government. Like the Commission's NPRM, AT&T ignores the legal distinction between a constitutional claim for an uncompensated taking and a common law claim for breach of contract. And like the Commission's NPRM, AT&T ignores the substantial body of economic literature

3. Comments of Cable & Wireless, IB Dkt. No. 98-192, at 4-5; Comments of Loral Space, IB Dkt. No. 98-192, at 2; Comments of MCI WorldCom, Inc., IB Dkt. No. 98-192, at 7-9; Comments of ABC, Inc., CBS Corporation, National Broadcasting Company, Inc., and Turner Broadcasting System, Inc., IB Dkt. No. 98-192, at 17; Comments of PanAmSat, IB Dkt. No. 98-192, at 4-5; Comments of Sprint Communications Company, L.P., IB Dkt. No. 98-192, at 6; Comments of Ellipso, Inc., IB Dkt. No. 98-192, at 6; Comments of IT&E Overseas, Inc., IB Dkt. No. 98-192, at 4; Comments of GE American Communications, Inc., IB Dkt. No. 98-192, at 7 (all filed Dec. 22, 1998).

4. Comments of AT&T Corp., IB Dkt. No. 98-192, at 5-11.

5. See AT&T's and TCI's Joint Reply to Comments and Joint Opposition to Petition to Deny or to Impose Conditions, In the Matter of Joint Application of AT&T Corp. and Tele-Communications, Inc. for Transfer of Control to AT&T of Licenses and Authorizations Held by TCI and Its Affiliates or Subsidiaries, CS Dkt. No. 98-178 (filed Nov. 13, 1998); see also Declaration of Janusz Ordover and Robert D. Willig (Nov. 12, 1998), attached to *id.*

6. Comments of AT&T Corp. at 6-7.

7. 518 U.S. 839 (1996).

8. 70 U.S. 51, 74 (1865).

Warren Y. Zeger, Esq.

January 29, 1999

Page 3

that explains the efficiency and necessity of having the government credibly committed when it enters into a bargain with a private party, such as Comsat. Nowhere does AT&T acknowledge the roles that cost recovery and incentive for investment play in shaping the applicable protections of contract and property. Like the Commission's NPRM, AT&T fails to recognize that the aspect of *Winstar* that is most relevant to the Commission's imposition of Level 3 direct access to Comsat's share of capacity on the INTELSAT system is the fact that *seven* Justices—Breyer, Kennedy, O'Connor, Scalia, Souter, Stevens, and Thomas—supported their divergent legal conclusions with the same economic reasoning that stressed cost recovery, incentive for investment, opportunism, and the government's need to make credible commitments. All of these deficiencies in AT&T's argument were addressed at length in my December 22, 1998, opinion letter in connection with the deficiencies of the Commission's own tentative conclusions in its NPRM. AT&T's argument warrants special skepticism because it is intellectually inconsistent with the position that AT&T simultaneously takes with respect to proposals to unbundle TCI's network for use by competing Internet service providers.

AT&T is also incorrect in arguing that Level 3 direct access would not be an unconstitutional taking, assuming that Comsat indeed has a property right. AT&T incorrectly describes the operative takings jurisprudence and erroneously describes the facts to which that jurisprudence is applicable.⁹ AT&T blurs the distinction between per se takings that result from physical invasions of property and "regulatory takings" that result from the government's imposition of noninvasive burdens on the use of one's property. My December 22, 1998, opinion letter explained the factual basis for the physical invasion resulting from Level 3 direct access, and hence the applicability here of the Supreme Court's decision in *Loretto v. Teleprompter Manhattan CATV Corp.* that even "a minor but permanent physical occupation of an owner's property authorized by government"¹⁰ would constitute a per se taking entitled to just compensation. AT&T cites *Loretto* but neglects to explain the decision's direct relevance.¹¹ Instead, AT&T simply asserts that Level 3 direct access would not effect a physical invasion of Comsat's property. That assessment is false for the reasons already explained at length in my December 22, 1998, opinion letter. My original conclusion is confirmed and reinforced by the supplemental analysis contained in Part IV of this letter. Again, one should ask whether, in making its arguments about the physical invasion of Comsat's property, AT&T would be prepared to concede that a Commission order to unbundle TCI's cable network for use by competing Internet service providers also would raise no question of a per se taking of property under *Loretto*.

AT&T also repeats the Commission's incorrect argument that Level 3 direct access would produce "voluntary" contractual arrangements.¹² As explained at length in my December 22, 1998, opinion letter, it is disingenuous and factually incorrect for the Commission, and now AT&T, to characterize as "voluntary" Comsat's participation in any transaction resulting from mandatory Level 3 direct access. As Part IV of this letter explains in greater detail, for Level 3 direct access actually to be implemented, it would be necessary to compel Comsat to grant its "consent" to INTELSAT to allow a third party to use space segment capacity that Comsat indisputably has the contractual right to control.

9. Comments of AT&T Corp. at 7-9.

10. 458 U.S. 419, 421 (1982).

11. Comments of AT&T Corp. at 7-8 & nn.23, 24.

12. *Id.* at 9.

Warren Y. Zeger, Esq.
January 29, 1999
Page 4

The logic that compulsion equals consent in questions of physical invasion of property is legally insupportable.¹³ For AT&T to equate the compulsion inherent in Commission-ordered Level 3 direct access with voluntary exchange is to invert the facts of Level 3 direct access and deconstruct the applicable standards of takings jurisprudence to the point of Orwellian *Doublespeak*.

It does not change matters that the Commission and AT&T would assert that such regulatory intervention would "promote the common good."¹⁴ Such phrasing is the window dressing of administrative procedure. One would hardly expect the Commission to purport to justify regulatory intervention in this docket on the grounds that it would "redistribute income to certain powerful telecommunications carriers by expropriating the quasi rents that Comsat would otherwise reasonably expect to earn in a deregulated marketplace and with which it would hope to recover the cost of, and a competitive return on, its asset-specific investments in INTELSAT space segment capacity."¹⁵ The regulatory arguments strategically advanced by a private company do not automatically acquire constitutional respectability simply because they come wrapped in extravagant claims of serving "the public interest" or "the common good" or "consumer welfare." Again, one must ask whether AT&T would so readily accept the determination that the Commission's mandatory unbundling of TCI's cable network for use by Internet service providers was merely a "voluntary" transaction, ordered by the Commission for "the common good" and predicated on AT&T's "consent."

The remainder of AT&T's takings analysis is riddled with errors of law, economics, fact, and logic. The fallacious arguments constructed from those errors have already been refuted in my December 22, 1998, opinion letter. Because AT&T is simply restating and endorsing the tentative conclusions of the Commission's NPRM, the remaining errors in AT&T's comments need be addressed only briefly.

AT&T argues that "[t]o constitute a taking, proposed regulation must defeat the economic viability of an entity."¹⁶ That standard does not apply to a physical invasion of property, which Comsat would suffer under Level 3 direct access and for which the controlling Supreme Court precedent is *Loretto*, not *Hope* or *Duquesne*, as AT&T incorrectly implies.¹⁷ Next, AT&T argues that "mere reduction of profits is not enough when all other ownership rights remain."¹⁸ Apart from the fact the *Loretto* applies because Level 3 direct access would be a physical invasion, this statement by AT&T has a fundamental logical flaw: All other ownership rights of Comsat in its space segment capacity would *not* remain. Comsat would suffer not only a reduction of profits, but also a fundamental deprivation of essential rights of ownership—the most obvious of which is the "right to exclude others," which the

13. *Gulf Power Co. v. United States*, 998 F. Supp. 1386, 1395 (N.D. Fla. 1998).

14. Comments of AT&T Corp. at 9 (citing NPRM at ¶ 40).

15. A firm's quasi rent equals its revenues minus its avoidable costs. Quasi rents are not the supracompetitive returns known as monopoly rents. See, e.g., J. GREGORY SIDAK & DANIEL F. SPULBER, *DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES* 419 (Cambridge University Press 1997).

16. Comments of AT&T Corp. at 9.

17. *Id.* at 9 n.29 (incorrectly citing *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944); *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310-14 (1989)).

18. *Id.* at 9.

Warren Y. Zeger, Esq.

January 29, 1999

Page 5

Supreme Court emphasized in *Dolan v. City of Tigard* and in earlier takings cases “is ‘one of the most essential sticks in the bundle of rights that are commonly characterized as property.’”¹⁹ Thus, contrary to AT&T’s assertion, it clearly would not be the true that “*all* other accoutrements of ownership [would] remain”²⁰ after the Commission had imposed Level 3 direct access and thereby denied Comsat any reasonable opportunity to recover the costs of its asset-specific investment in INTELSAT.

AT&T also is incorrect in repeating the specious argument in the Commission’s NPRM that Comsat would be seeking just compensation for loss of monopoly rents.²¹ My December 22, 1998, opinion letter explained at length that this characterization is a distortion of Comsat’s constitutional argument. Moreover, the economic premise that Comsat earns monopoly rent is contrary both to the facts and to the Commission’s own deregulation of much of Comsat’s business on the grounds that Comsat is nondominant over “thick” routes. In other words, AT&T knocks down a straw man argument that Comsat does not even make. Furthermore, despite the sophistication of the legal argumentation and expert economic testimony that AT&T has so often provided in submissions to the Commission, AT&T shows in its comments in this docket that it does not understand (or chooses not to acknowledge) the difference between monopoly rent and quasi rent when it states that “[t]here is no reason to believe that a competitive market for access to INTELSAT would not yield reasonable profits” for Comsat.²² The relevant issue is whether AT&T and other seekers of Level 3 direct access would appropriate from Comsat the stream of quasi rents—*not* a stream of monopoly rents—with which Comsat would earn a recovery of, and a competitive return on, its investment in the INTELSAT system.

Finally, AT&T argues that Comsat was on notice that the government might destroy its investment-backed expectations. As noted in my December 22, 1998, opinion letter, this argument ignores that Congress created Comsat as a private corporation to perform a specific mission in U.S. international telecommunications policy. It strains logic past the breaking point for AT&T to acknowledge on the one hand (as it is compelled by the facts to do) that Congress directed Comsat to accomplish certain goals with respect to the creation of an international satellite network, and then to argue on the other hand that the Commission could freely frustrate Comsat’s accomplishment of that mission by raising its cost of capital through the creation of a risky regulatory environment in which investors would be unreasonable to expect a return of, and a competitive return, their investment. Moreover, the property owner’s investment-backed expectation is a factor relevant to determining whether a *regulatory* taking has occurred. It is not a factor that is analyzed when a physical invasion of property has occurred, as would be Comsat’s case under the mandatory imposition of Level 3 direct access. In Comsat’s case, *Loretto* would control, a *per se* taking of property would be established, and the inquiry would immediately advance to the determination of whether Comsat had received from the federal government the requisite measure of just compensation as part of the regulatory intervention that introduced Level 3 direct access.

19. 512 U.S. 374, 393 (1994) (quoting *Kaiser Aetna v. United States*, 444 U.S. 164, 176 (1979)).

20. Comments of AT&T Corp. at 9 n.30 (quoting *South Terminal Corp. v. EPA*, 504 F.2d 646, 679 (1st Cir. 1994) (emphasis added)).

21. *Id.* at 10.

22. *Id.*

J. GREGORY SIDAK

Warren Y. Zeger, Esq.

January 29, 1999

Page 6

II. LEVEL 4 DIRECT ACCESS WOULD EFFECT AN UNCOMPENSATED TAKING OF PROPERTY

In its NPRM, the Commission declined to propose that Comsat be required to permit its customers to have Level 4 direct access to INTELSAT. The Commission tentatively concluded that such regulatory intervention would contravene the requirement under the Communications Satellite Act of 1962 that Comsat be the sole U.S. participant in INTELSAT. BT North America and Cable & Wireless urge the Commission to reconsider that tentative conclusion of law.²³ The merits of these arguments as a matter of statutory interpretation are addressed by Comsat in its reply comments, filed simultaneously with this letter. To that statutory analysis it may be simply and briefly added here that, as a matter of constitutional law, Level 4 direct access would present an even clearer taking of Comsat's property than would Level 3 direct access.

Level 4 direct access would enable Comsat's current customers not only to obtain INTELSAT space segment at INTELSAT's tariff rate rather than Comsat's tariff rate, but also to make a capital investment in INTELSAT in proportion to the customer's use of the INTELSAT system at INTELSAT's tariff rates. Level 4 direct access would be a physical invasion of Comsat's private property in the INTELSAT system for all of the same reasons that Level 3 direct access would be a physical invasion. Stated differently, if INTELSAT were not privatized but instead were to retain its current ownership and governance structure, Level 4 direct access would effect the same uncompensated taking of Comsat's property that Level 3 direct access would.

On the other hand, if INTELSAT were subsequently privatized, the magnitude of the uncompensated taking of Comsat's property that would arise from Level 4 direct access would exceed that from Level 3 direct access. Unlike Level 3 direct access, Level 4 direct access would confiscate what might be called the "privatization premium" associated with Comsat's ownership share of INTELSAT. This additional form of confiscation explains the appeal of Level 4 direct access to other companies. To the extent that INTELSAT as a privatized entity would have significantly greater economic value, that expectation of higher discounted net cash flows is reflected pro rata in Comsat's share price because of Comsat's ownership interest in INTELSAT. That expectation is based on the value in INTELSAT that is likely to be unlocked if INTELSAT can successfully transform itself from a public enterprise to a private enterprise.

The effect of Level 4 direct access would be to allow a late comer to purchase, at a significant discount to fair market value, an ownership interest in the enhanced level of discounted net cash flows associated with INTELSAT's potential privatization. Unlike Comsat, such an interloper has not made investments over many years to support customers' access to the INTELSAT system from the United States. Now, through Level 4 direct access, it would be able to dilute Comsat's own share of INTELSAT's future net cash flows, including such net cash flows earned after INTELSAT's privatization. The price to that company of appropriating a portion of Comsat's ownership interest in

23. Comments of BT North America, Inc., IB Dkt. No. 98-192, at 12-16 (filed Dec. 22, 1998); Comments of Cable & Wireless at 10-11.

Warren Y. Zeger, Esq.

January 29, 1999

Page 7

INTELSAT would not be that portion's fair market value, but rather a price arbitrarily determined on the basis of the current capital investment required for the INTELSAT system. Put differently, Level 4 direct access would enable other companies to use the Commission's regulatory processes to appropriate some or all of Comsat's share of the value that would be created by changing the governance structure of INTELSAT.

The premium to be earned from an improvement in the governance structure of INTELSAT is a valuable property interest. The effect of Level 4 direct access would be to take that right from the community of Comsat's shareholders and give it to other parties. Nothing in the structure of Level 4 direct access would award Comsat just compensation for the valuable right that such mandatory access would confiscate from Comsat's shareholders and redistribute to these shareholders of other companies. As explained in my December 22, 1998, opinion of law, the case law holds that an uncompensated confiscation of Comsat's private property would violate the Takings Clause of the Fifth Amendment to the U.S. Constitution. This confiscation of Comsat's expected "privatization premium" in INTELSAT would be an additional economic harm caused by Level 4 direct access that would not occur under Level 3 direct access.

III. "FRESH LOOK" AND "PORTABILITY" WOULD EFFECT AN UNCOMPENSATED TAKING OF PROPERTY

Several commenters urge the Commission not only to mandate Level 3 direct access, but also to require a "fresh look" period during which Comsat's existing customers could freely abrogate their contracts for space segment capacity.²⁴ MCI WorldCom and Sprint further urge the Commission to order "portability" of INTELSAT space segment capacity such that any of Comsat's departing customers could control such capacity when the customer switched to a new carrier having access to INTELSAT.²⁵ Both proposals would constitute unconstitutional takings of Comsat's property.

Fresh look is the shorthand for a regulatorily created right of Comsat's customers unilaterally to abrogate their contracts with Comsat for the supply of INTELSAT space segment capacity, with no termination charge or other adverse consequence. The customer's motivation to secure such a right is to achieve greater bargaining power with which to renegotiate, at a lower price, an existing contract with Comsat for the supply of INTELSAT space segment capacity. Thus, fresh look is in essence a government-mandated transfer of Comsat's existing contract rights.

The proponents of fresh look cannot justify such regulatory intervention into private contracting on the grounds that it is necessary to correct previous inequality of bargaining power between Comsat and its customers. Comsat's customers are not consumers or small businesses. They are, rather, sophisticated telecommunications firms—such as AT&T, MCI WorldCom, and Sprint—which had entered into contracts or contract amendments with Comsat as recently as a few months before the Commission's

24. Comments of AT&T Corp. at 13-15; Comments of ICG, IB Dkt. No. 98-192, at 5-6 (filed Dec. 22, 1998); Comments of Loral Space at 8-9; Comments of MCI WorldCom, Inc. at 25-38; Comments of PanAmSat at 9-10; Comments of Sprint Communications Company, L.P., at 10-13.

25. Comments of MCI WorldCom, Inc. at 24-30; Comments of Sprint Communications Company, L.P., at 10-14.

Warren Y. Zeger, Esq.
January 29, 1999
Page 8

issuance of its NPRM in this proceeding.

Comsat would have limited bargaining power in any fresh-look renegotiation. A high percentage of Comsat's costs is sunk. The Commission's imposition of fresh look would thus enable customers to expropriate Comsat's quasi-rent. Suppose that to carry out production a firm must invest k dollars. Suppose further that the investment k is irreversible, so that k represents sunk costs. The firm has operating costs c and expects to earn revenues R . The firm's economic rent is defined as revenues net of operating cost and investment cost, $R - c - k$. Economic rent provides the incentive for entry. The firm's quasi rent is defined as net revenue, $R - c$. The quasi rent provides incentives to stay in the industry after entry costs have been sunk. Having sunk k , the firm decides whether or not to produce on the basis of its comparison of R and c only. It would manifest the "fallacy of sunk costs" for the firm to base its production decision on the magnitude of k . Thus, after k is sunk, only quasi rents—not economic rents—affect the firm's decision whether or not to produce the good. But that condition does *not* mean that pricing—and government policies that have the effect of regulating pricing, as fresh look would in Comsat's case—should not take into account sunk costs k . *Before* a firm has sunk k , it is economic rents that count, not quasi rents. To ignore k by allowing fresh-look renegotiation of the price of space segment capacity would be to ignore the expectations of Comsat's investors when the investment k was made to create that capacity. The Commission's retroactive imposition of fresh look would rest on the fallacy that Comsat's investment decision depended on quasi rents alone and ignored the magnitude of k .

Buyers and sellers enter into contracts on the basis of economic rents. The purpose of contract law is to allow efficient contracts to form. Otherwise, without the protection of contract law, buyers and sellers would be tempted to behave opportunistically, taking advantage of the irreversible investment of the other party. To illustrate that point, suppose that R is determined by a buyer and seller negotiating a contract before k is sunk. After the parties enter into the contract, one of the parties sinks cost k . The other party then has an incentive to behave opportunistically by offering a payment—such as through the adoption of fresh look—that is only slightly above c , thus capturing the investor's quasi rent. That situation cannot be justified by giving c the new label "forward-looking economic costs." Contract law protects the expectation, $R - c$, which equals the investor's quasi rent. If the seller anticipated that the buyer could reduce the payment to c after the contract was formed, then the seller would have no incentive to make a transaction-specific investment in the first place.

Because of its confiscatory implications, fresh look would give Comsat especially compelling claims for damages against the United States. The Commission's imposition of fresh look would take from Comsat contract rights for which it bargained. Comsat is a private, investor-owned entity, and its contract rights are property. It is well established that "[v]alid contracts are property, whether the obligor be a private individual, a municipality, a state, or the United States."²⁶ The government cannot simply take that property, as fresh look would do, without paying for it. An uncompensated taking of that sort would "nullify express terms of [a] company's contractual obligations" and thus would be unconstitution-

26. *Lynch v. United States*, 292 U.S. 571, 579 (1934).

Warren Y. Zeger, Esq.

January 29, 1999

Page 9

al.²⁷ By abrogating Comsat's contracts with its customers—and nullifying their express contractual obligations to Comsat—the Commission's imposition of fresh look would confiscate Comsat's property interest and thus expose the U.S. Treasury to claims for compensation under the Takings Clause.

The proponents of fresh look might point to antitrust cases in which a company holding a monopoly that had been adjudicated to be unlawful was required to allow other parties to extricate themselves from contracts that had been used to maintain that monopoly. But the Commission cannot assume as a matter of law that Comsat is a monopoly. To the contrary, the Commission found in its nondominance order that Comsat lacks—and, at the time that it negotiated most of its contracts with these customers, lacked—market power for the vast majority of its services. The FCC further found that Comsat's long-term contracts were not anticompetitive because customers can and do switch providers. In 1998, during debate on the fresh look provision contained in section 642 of H.R. 1872, Representative Tauzin remarked: “[T]his bill does something very strange. . . . This bill . . . gives to AT&T and MCI and the other customers the right unilaterally not to honor their contracts anymore, without any finding that COMSAT has done anything wrong or that these contracts are anti-competitive to any extent.”²⁸ The proposition that Comsat and INTELSAT face competition is further substantiated by Professors Jerry R. Green and Hendrik S. Houthakker of Harvard University and Mr. Johannes P. Pfeifenberger of the Brattle Group in their report filed with Comsat's initial comments in this docket. If, as the Commission concluded in its nondominance proceeding for the vast majority of Comsat's services, Comsat is not a monopolist, then any attempt to analogize fresh look to an injunctive remedy in antitrust law necessarily must fail.

Severe constitutional infirmities also plague “portability”; indeed, the very label is a misnomer. Comsat's capacity on the INTELSAT system can be deemed to be “portable” only in the same sense that a person's personal property is “portable” after a thief has absconded with it. It is no comfort to the owner of a car that has been rendered “portable” that she no longer will have to incur the avoidable costs of gasoline and maintenance associated with owning and operating it. The effect of portability would be to force Comsat, if any of its customers switched to direct access, to surrender INTELSAT capacity for which it has secured contractual rights of use. Portability would dispossess Comsat of its right to use INTELSAT circuits and transponder capacity. By government order, that capacity would be physically occupied by another party. Seen in this light, portability is analogous to the government's ordering a tenant to allow a third party to move into the tenant's already-rented home. Such an invasion of Comsat's property would be a *per se* taking, as explained in my December 22, 1998, opinion of law. Moreover, although MCI WorldCom and Sprint are vague as to what their proposal of portability would entail and how it would work in practice, this proposed regulatory intervention would evidently take not only Comsat's space segment capacity, but also its investment share in INTELSAT. Portability would thus unconstitutionally confiscate both the return *of* and the return *on* some or all of Comsat's investment in INTELSAT.

27. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 247 (1978).

28. 144 CONG. REC. H2850-02, H2,851 (daily ed. May 6, 1998).

J. GREGORY SIDAK

Warren Y. Zeger, Esq.
January 29, 1999
Page 10

IV. FURTHER ANALYSIS OF THE PHYSICAL INVASION OF COMSAT'S PROPERTY THAT WOULD RESULT FROM LEVEL 3 DIRECT ACCESS

Since writing my December 22, 1998, opinion of law, I have learned additional facts from Comsat that bear on my conclusion that the Commission's order of mandatory Level 3 direct access would be a physical invasion that would constitute a per se taking of Comsat's property. These additional facts reinforce that earlier conclusion of law.

Assume for purposes of discussion that the Commission has ordered Level 3 direct access and that one of Comsat's customers—say, MCI WorldCom—subsequently seeks to procure space segment capacity directly from INTELSAT. The Commission's order of Level 3 direct access would not alter the fact that Comsat would continue to have the contractual right to control the use of INTELSAT's circuits to and from the United States. Therefore, for INTELSAT to provide capacity directly to MCI WorldCom, INTELSAT would first have to obtain Comsat's consent to use the circuits that Comsat lawfully controls. At an operational level, such consent would be recorded in an INTELSAT document entitled, "Signatory Access/Liability/Investment Authorization Form," which must be executed by the INTELSAT signatory granting direct access (in this case, Comsat). The Commission's imposition of Level 3 direct access would have the effect of compelling Comsat to grant its "consent." Such a transaction would be analogous to the government coercing someone to lease an apartment from X and immediately sublease the apartment to Y. The Commission might take the view that it has the power to compel Comsat to execute the Signatory Access/Liability/Investment Authorization Form. But that view would add yet another layer of compulsion to the direct access transaction that the Commission's NPRM has already incorrectly characterized as an act of voluntary exchange.

Moreover, the uncompensated taking of Comsat's property would be aggravated if, as appears possible, Comsat remained financially liable to INTELSAT for MCI WorldCom's failure to pay for its use of space segment capacity under mandatory Level 3 direct access. The Signatory Access/Liability/Investment Authorization Form contains section 10, which reads, with original emphasis and capitalization, as follows:

Liability for Payment: To the extent permitted by the INTELSAT Board of Governors, **the Signatory elects that the Appointed Customer, and not the Signatory, be held liable to INTELSAT for payment of utilization and related charges ATTRIBUTABLE TO THE ACCESS FOR WHICH THE SIGNATORY HAS AUTHORIZED FOR THE CUSTOMER IN THIS AUTHORIZATION FORM.** Such transfer of Liability will be subject to appropriate contractual arrangements between INTELSAT and the customer and may be subject to receipt by INTELSAT of satisfactory collateral.

The section further provides, with original emphasis, the following: **"If Signatory selects 'NO' for this item, the Appointed Customer's utilization bills will automatically be copied to Signatory."** If proponents of Level 3 direct access believe that the Commission may compel Comsat to execute a document manifesting its "consent" to the physical invasion of its property, those same proponents may also believe that the Commission could compel such "consent" even if INTELSAT's Board of Governors did not permit Comsat to devolve liability for payment to MCI WorldCom as a purchaser of Level 3

J. GREGORY SIDAK

Warren Y. Zeger, Esq.

January 29, 1999

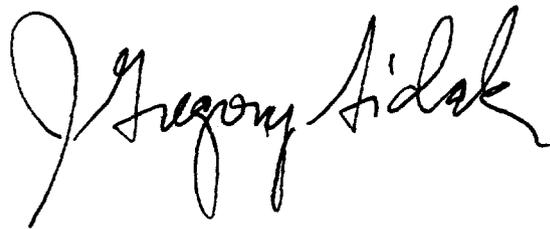
Page 11

direct access. In that case, Comsat would be made to "consent" not only to an unconstitutional physical invasion of its property, but also to its forced indemnification of MCI WorldCom's purchase of space segment capacity. As there is no discussion in the Commission's NPRM of Comsat's compulsory role as guarantor of MCI WorldCom's purchases of space segment capacity, Comsat's performance of that valuable function would evidently be uncompensated and thus would constitute another taking of Comsat's property.

CONCLUSION

The companies filing initial comments endorsing Level 3 direct access have presented a superficial and incorrect analysis of the takings and regulatory contract issues on which the Commission requested comment. Moreover, the Commission's adoption of certain other policies not advanced in its NPRM—namely, mandatory Level 4 direct access, fresh look, and portability—would effect an uncompensated taking of Comsat's property. The legal conclusion that Level 3 direct access would effect an unconstitutional physical occupation of Comsat's property holds even more forcefully in light of additional facts concerning the nature of the contractual relationships between Comsat, INTELSAT, and a would-be user of Level 3 direct access.

Sincerely,

A handwritten signature in black ink, reading "J. Gregory Sidak". The signature is written in a cursive style with a large initial "J" and a long, sweeping underline.